Scottish Economic Insights

Office of the Chief Economic Adviser

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November 2023

Scottish Government
Riaghaltas na h-Alba

Contents

Data up to: 20 November 2023
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Overview

Scottish Economic Insights is a new biannual report which provides more in depth economic analysis and insight on the key themes presented in the monthly Scottish Economic Bulletin and highlights some of the technical economic analysis being undertaken within Scottish Government. This edition of the report provides further analysis on three key themes: inflationary pressures, the weakness in economic growth, and labour market resilience. It also showcases two pieces of technical analysis on deflators and Gross National Income.

The economy has faced a succession of significant shocks in recent years from EU exit, the pandemic and most recently the inflation shock arising from the war in Ukraine. Collectively, they have led to a range of economic risks which have evolved over the past year as the economy has continued to recover, adjust and adapt to these persistent challenging conditions and elevated uncertainty.

The sharp rise in inflation in 2022, largely due to the war in Ukraine and its impact on energy and wider commodity prices, has eased over 2023. While inflationary pressures have been widespread across goods and services, the significance of energy and food within the budgets of both households and businesses has been a particularly challenging aspect of this cost crisis.

While inflation is now on a downward trend, it remains notably higher than in recent years and businesses and households are continuing to adjust to such a permanent upward shift in price levels, alongside the rapid shift to a higher interest rate environment. Furthermore, the latest forecasts indicate that the ongoing reduction in inflation will be more gradual and will remain above the 2% target until the second half of 2025. This edition considers the latest drivers of inflation within the Consumer Prices Index basket and also the Scottish GDP deflator which provides insights on labour costs and gross operating surplus, which includes company profits.

During this inflationary shock, economic growth has remained subdued and broadly flat since the start of 2022 as cost pressures and weak demand have slowed. While economic output has largely recovered to its pre-pandemic level at the Scotland level, parts of the economy, particularly in production, are significantly below, emphasising how the succession of shocks continue to impact differently across sectors.

Looking ahead, independent growth forecasts remain subdued for 2024, with downside risks arising from weak global growth and ongoing cost pressures and uncertainty expected to continue to dampen consumer spending and business investment. However, the economy has remained resilient, in the face of these challenges and there is strong possibility that growth will surprise on the upside given both the opportunities for external investment in Scotland and also the performance of key export sectors.

Alongside the analysis of GDP, this edition also presents the latest Gross National Income Data for Scotland up to 2021, which provides insights into the flows of income from and to Scotland and provides an estimate of Scotland's domestic economic wealth.

The labour market has remained resilient during 2023 with low unemployment and indications that businesses are continuing to add to their headcount going into the final quarter of the year. The underlying tightness in the labour market has eased slightly as the pace of recruitment activity has slowed during the year. However, nominal earnings growth has remained robust and, coupled with the fall in the inflation rate, this has seen a return to real earnings growth. The report looks at the latest earnings data split by public and private sector, which indicate a narrowing in growth rates and a narrowing in the gender pay gap.

Finally, while the return to positive real earnings growth is good news for household incomes, the ongoing weakness in consumer sentiment and lower demand for labour mean that consumption is unlikely to drive growth in the near term. With inflation expected to remain above target for longer, economic growth is likely to be driven by external demand in Scotland, and will be a gradual process.

Introduction

Following the economic shocks of EU-exit, the pandemic and high inflation, economic growth has remained subdued as inflation has gradually fallen from its most recent peak at the end of 2022, while the labour market has been particularly resilient with low unemployment.

The rise in interest rates is playing an increasing role in slowing economic activity as cost challenges continue to impact on household budgets and business investment decisions. While expectations are for weak growth to continue into 2024, inflationary pressures are expected to continue to ease at a more gradual pace and the underlying weakness in demand is expected to start feeding through to the labour market. Furthermore, weak global growth and the conflict in Israel and Gaza add to the risks and uncertainty in the global economic outlook.

This edition of the Scottish Economic Insights provides an update on current economic risks and provides further analysis on three key themes in current economic conditions: inflationary pressures, the weakness in economic growth, and labour market resilience.

Economic Risks

Economic risks have evolved over the past year as the economy has continued to recover from the legacy effects of the pandemic while progressing through the inflation shock, with conditions improving in some areas while remaining acutely challenging in others.

The risks to the economic outlook and the implications for businesses and consumers, the labour market and more widely are captured in the table below.[1] This sets out a range of economic indicators through which emerging economic risks are being monitored. Red risks are expected to remain weak with significant downside risks, amber risks are expected to remain fragile with downside risks, and green risks are expected to remain broadly stable/fine relatives to historical trends.

[1] Sources in the table below: **Economic Performance**: GDP statistics, S&P Global RBS PMI. **Labour Market**: Labour Market Statistics, S&P Global RBS Report on Jobs, Business Insights and Conditions Survey (BICS), ONS Real Time Information Statistics. **Trade**: HMRC Regional Trade Statistics, S&P Global UK PMI, BICS, Economic Policy Uncertainty (EPU). **Prices**: ONS, Food and Agricultural Organisation of the UN. **UK Public Finances**: ONS. **Outlook**: S&P Global RBS PMI, Scottish Consumer Sentiment Indicator, Economic Policy Uncertainty.
2 We also continue to monitor a wide range of indicators in our Scottish Economic Bulletin: [Scottish economic bulletin: October 2023 - gov.scot (www.gov.scot)](https://www.gov.scot)

Snapshot of Indicators

Colour coding reflects assessment of economic risk for an indicator during 2023, relative to historic trends.

Red - expected to remain weak with significant downside risks // **Amber** - expected to remain fragile with downside risks // **Green** - expected to remain broadly stable/fine relative to historic trends.

Economic Performance

Indicator	Latest Data		Monthly Change	Risk
Monthly Real GDP growth	0.1%	Aug-23	▼	R
Business Activity Index (>50 = growth)	46.5	Oct-23	▼	R
New Business (>50 = growth)	48.2	Oct-23	▼	R

Labour Market

Indicator	Latest Data		Quarterly Change	Risk
Unemployment Rate (experimental)	3.9%	Jul - Sep 23	▼	G
Employment Rate (experimental)	74.3%		—	G
Inactivity Rate (experimental)	22.7%		▲	G
			Monthly Change	
Permanent Job Demand Index (>50 = growth)	43.8	Oct-23	▼	A
% of firms reporting staff shortages	25.4%	Oct-23	▼	A
Nominal median earnings annual growth	6.7%	Oct-23	▼	A
Real median earnings annual growth	2.0%	Oct-23	▲	A

Trade

Indicator	Latest Data		Monthly Change	Risk
Goods Exports (ex oil and gas) (Nominal growth v same period in 2022)	13.2%	Year to Q2 2023 v Year to Q2 2022	n/a	G
Share of businesses exporting less than a year ago (or unable to export)	17.4%	Sep-23	▼	A
Share of businesses importing less than a year ago (or unable to import)	14.5%	Sep-23	▲	A
UK Manufacturing Suppliers' Delivery Time (>50 = improving)	51.8	Oct-23	▼	G
World Geopolitical Risk Index (1985-2019 average =100)	215	Oct-23	▲	R

Prices

Indicator	Latest Data		Monthly Change	Risk
CPI Inflation Rate (UK)	4.6%	Oct-23	—	A
PPI Input Price Inflation Rate	-2.6%	Oct-23	▼	A
Oil Brent Crude ($/b)	$81.08	20-Nov-23	▼	A
International Food Prices Index (2014-2016 = 100)	120.6	Oct-23	▼	A
Exchange Rate (£/$)	1.25	20-Nov-23	▲	A
Exchange Rate (£/€)	1.14	20-Nov-23	▼	A

UK Public Finances

Indicator	Latest Data		Annual Change	Risk
Bond Yields (UK 10 -year)	4.1	20-Nov-23	▲	R
Public Sector Net Borrowing (PSNB ex) (Financial year to date)	£98.3 bn	Oct-23	▲	R
Public Sector Current Receipts (FY to date)	£595.2 bn	Oct-23	▲	A
Public Sector Current Expenditure (FY to date)	£693.5 bn	Oct-23	▲	A
Public Sector Net Debt ex BoE (% of GDP)	88.6%	Oct-23	▲	R

Outlook

Indicator	Latest Data		Monthly Change	Risk
Business Future Expectations (>50 = growth)	58.9	Oct-23	▼	A
Consumer Sentiment Index (>0 = positive)	-7.4	Sep-23	▲	R
Consumer Sentiment Personal Index (>0 = positive)	-12.9	Sep-23	▲	R
Consumer Sentiment Economy Index (>0 = positive)	0.8	Sep-23	▲	R
Economic Policy Uncertainty Index (UK) (pre-2011 average = 100)	106	Oct-23	▼	A

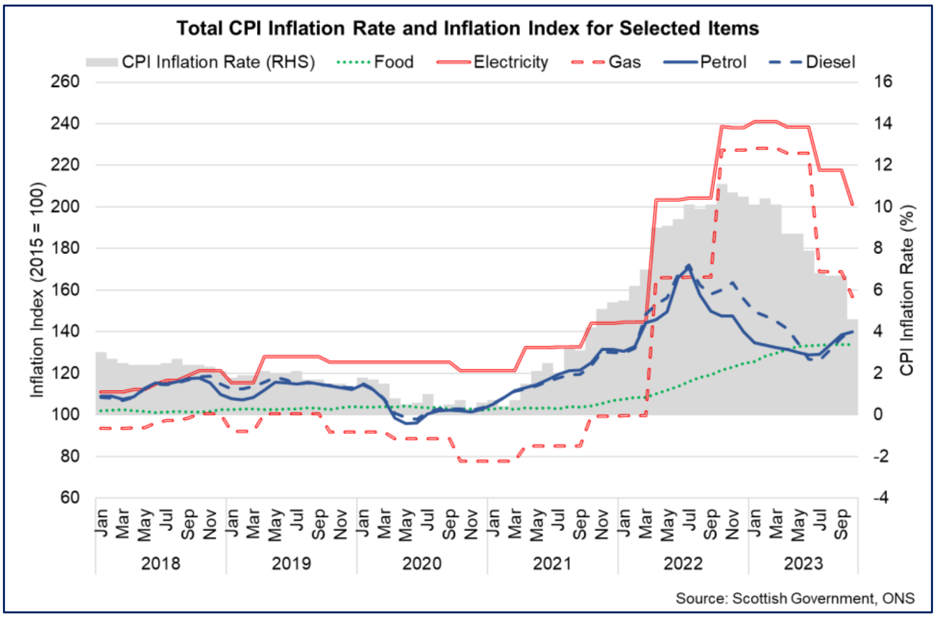
The red risks are around economic growth, business activity and consumer sentiment, reflecting that economic growth has been broadly flat since the start of 2022 with indications of weakening business activity going into the fourth quarter of the year. Weakness in consumer sentiment indicators also emphasises the persistent cost of living challenges that are impacting households and the significant downside risks to consumption growth in the near term. Geopolitical risk is a further downside risk.

Amber risks include risks related to prices which have slightly reduced over the past year as the inflation rate has eased back from its peak, however they very much remain amber reflecting the fragility of the improvements observed in inflation and the downside risks that remain. The easing in inflationary pressures have also fed through to improvements in earnings growth indicators which have returned to positive real terms growth in recent months, though also remain fragile on the back of such a sharp negative impact over the previous year.

Green risks include labour market indicators. At a headline level, risks remain lowest in the labour market with low unemployment and high employment continuing to indicate the resilience of the labour market through this challenging period. However, the slight slowing in recruitment activity over the course of 2023 presents amber risks within the labour market and a greater degree of fragility than earlier in the year.

Inflationary Pressures

A key economic challenge over the past year has been the combination of high inflation and slowing economic growth with the risks that rising interest rates could further stall economic growth and increased international uncertainty could raise the persistence of inflationary pressures.



UK inflation fell to 4.6% in October, down 6.5 percentage points over the past year and is now at its lowest rate for two years having peaked at 11.1% in October 2022.[2]

The fall in inflation largely reflects the fall in consumer energy prices with electricity prices falling 15.6% over the past year and gas prices down 31%. Food prices continue to grow strongly at 10.1% however the pace of growth has slowed notably from its peak of 19.6% in March this year.

Disaggregating the Scottish GDP deflator

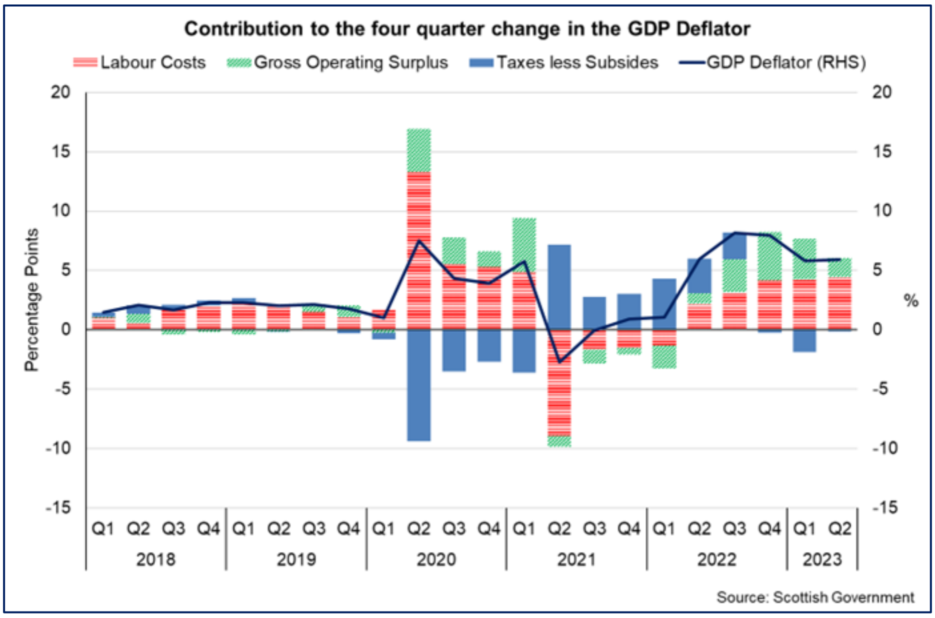
Consumer Prices Indices (CPI and CPIH) provide the official estimates of consumer price inflation in the UK and internationally. They estimate changes in the price level for a basket of goods and services (e.g. energy and food prices) and are critical to understanding the drivers of inflation.

The GDP deflator is an alternative and broader measure of inflation which reflects the prices of all goods and services that comprise GDP.[1]

Disaggregating the GDP deflator by the income approach can provide insights on how labour costs (labour earnings), gross operating surplus (primarily corporate earnings), and production taxes less subsidies have contributed to inflation.[11]

[2] Consumer price inflation, UK - Office for National Statistics

As with CPI and CPIH, the GDP deflator has captured the inflationary shock, peaking at 8.2% in Q3 2022, and eased back to 5.9% in Q2 2023.



As inflation started to rise at the end of 2021, this was initially driven by positive contributions from taxes less subsidies, which primarily reflected the withdrawal of pandemic related subsidies. However, this was accompanied by positive contributions from labour earnings and operating surplus over 2022 and in the first half of 2023. Between 2020 Q2 and 2022 Q3, a year after the end of the Coronavirus Job Retention Scheme, there are unusually large contributions to the GDP deflator from the subsidies which were introduced to support businesses during the COVID-19 pandemic.

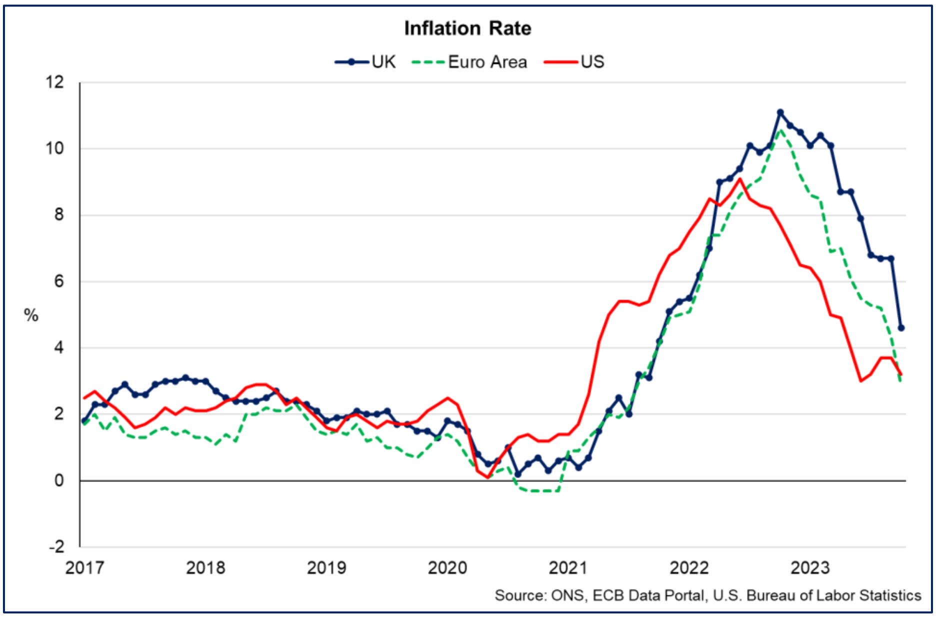
Subsidies contribute negatively to the GDP deflator, because the income they provide to factors of production is not generated through economic activity but transferred from Government. This negative contribution is most prominent in the graph in two instances – furlough payments to furloughed workers in 2020, and most recently the Energy Price Guarantee at the end of 2022 and into 2023.

When the GDP deflator peaked at 8.2% in Q3 2023, taxes less subsidies contributed 2.2 percentage points, gross operating surplus 2.7 percentage points and earnings 3.2 percentage points.

Inflation has gradually fallen since then partly driven by negative contributions from taxes less subsides in 2023 (-0.1 percentage points in Q2 2023) and lower contributions from gross operating surplus (1.5 percentage points in Q2 2023). Labour earnings have continued to strengthen and contributed 4.5 percentage points in Q2 2023, reflecting the increase in wage growth.

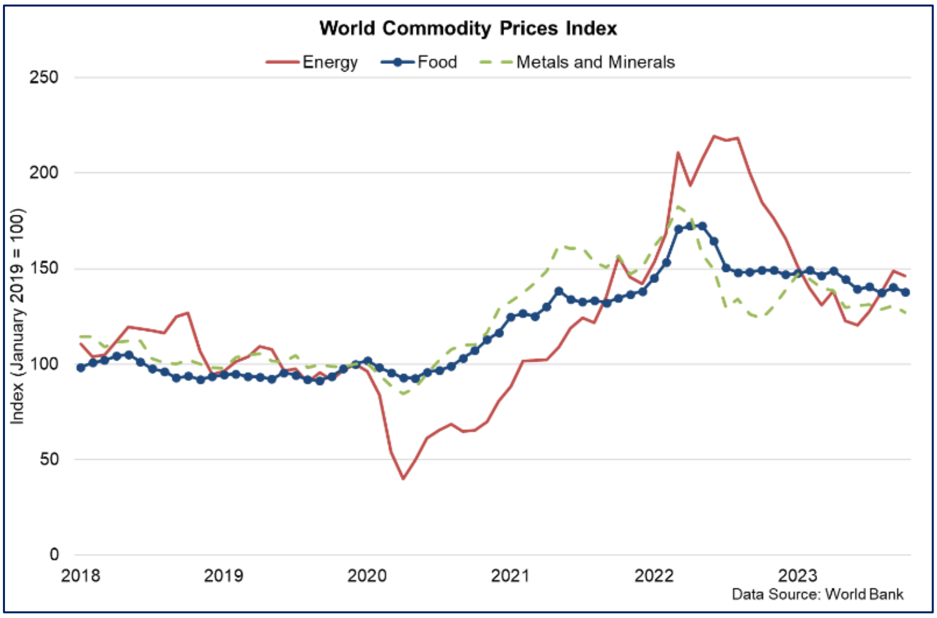
Overall, the disaggregation of the GDP deflator indicates that both labour earnings and, to a lesser extent, gross operating surplus have continued to contribute positively to inflationary pressures in 2023. However, the contribution of gross operating surplus in the latest quarter was relatively small at 1.5 percentage points. This is broadly comparable to the UK as a whole, with the Bank of England indicating that the contribution to inflation from Gross Operating Surplus is not from corporate profits, but from other sources of income.

Internationally, inflation rates have also fallen sharply over the year. In the Euro Area, inflation fell to 2.9% in October, down 7.7 percentage points over the year while US inflation fell 4.1 percentage points over the past year to 3.2%. In each area, inflation is at more consistent rates with those at the end of 2021 prior to the outbreak of war in Ukraine.[3],[4]

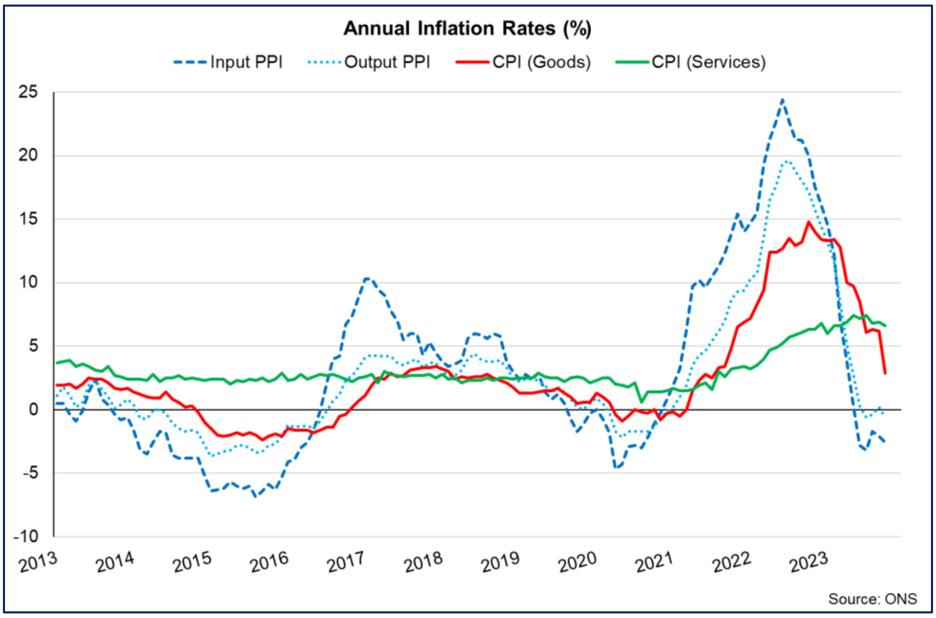


The moderation in international commodity prices and the feed through to consumer prices has played an important role in this during 2023, falling 7.7% over the past year, while metals and minerals prices have remained more stable and grew 2.4%. Energy prices have proved slightly more volatile but, despite an upward trend in recent months reflecting the rise in oil prices in the second half of the year, have fallen 20.9% over the past year.[5]

[3] ICP.M.U2.N.000000.4.ANR | ECB Data Portal (europa.eu)
[4] Bureau of Labor Statistics Data (bls.gov)
[5] Commodity Markets (worldbank.org)

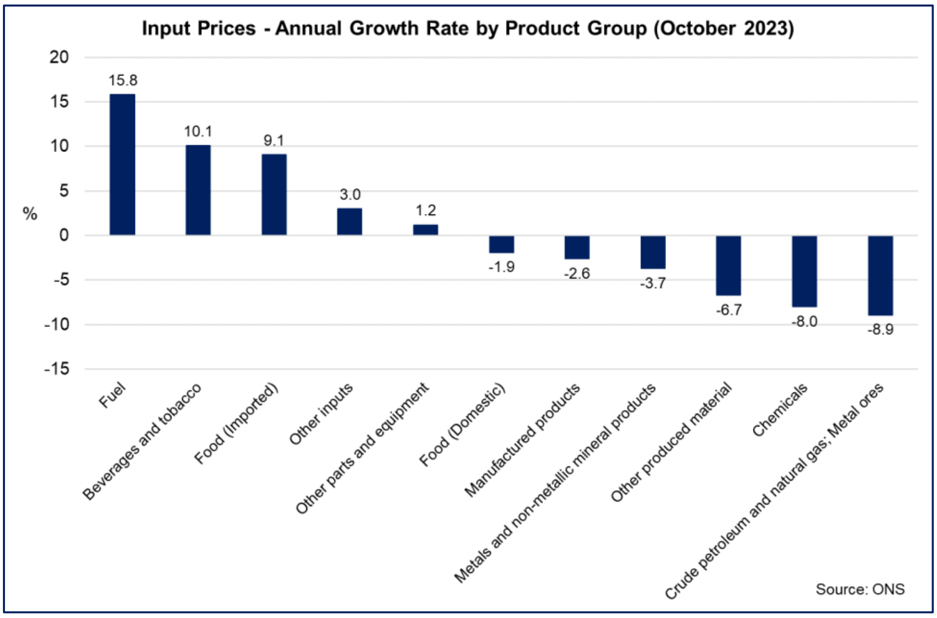


The fall in commodity prices, alongside wider improvements in supply chains, has supported the fall in producer input costs in the UK which has further fed through to the fall in consumer prices. Producer input prices fell 2.6% over the year to October 2023 and has fed through to consumer goods price inflation falling to 2.9% in October while services price inflation fell more moderately to 6.6% and is forecast to continue falling more slowly over the coming months.[6]



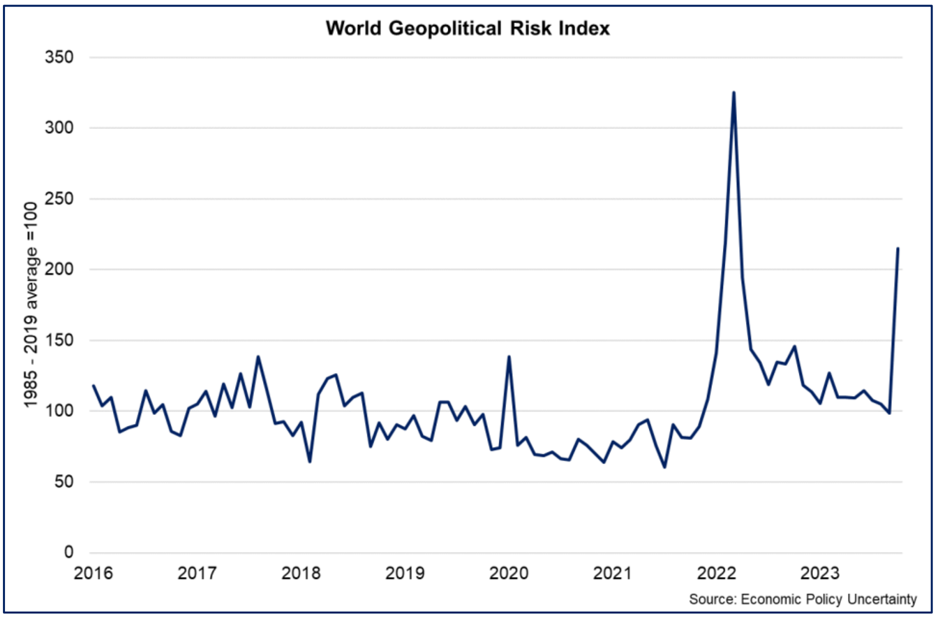
The fall in producer prices over the past year has been most notable in crude petroleum and natural gas prices (-8.9%) and chemicals (-8%). Input inflation rates for fuel, beverages/tobacco and imported food remain robust and highlight that while services price inflation is likely to be slower to ease than good price inflation, the international context and its impact on global inflationary pressures remains a risk to goods price inflation.

[6] Producer price inflation, UK Statistical bulletins - Office for National Statistics (ons.gov.uk)



The war in Ukraine continues to present a risk to global commodity prices, with the events in Gaza and Israel presenting a new risk to oil and gas prices, and to a greater extent if the wider region and its energy supplies are impacted.

The Geopolitical Risk Index illustrates the spikes in world geopolitical risks at the start of the war in Ukraine at the start of 2022 and then again most recently in October 2023 when the in Gaza-Israel escalated.[7]



Looking ahead, inflation is forecast to continue on its downward trajectory towards the 2% target as the impacts of higher interest rates and weakening demand weigh on inflationary pressures. Market expectations are for the Bank Rate to remain around its current rate of 5.25% until Q3 2024 before declining gradually to 4.25% by the end of 2026.[8]

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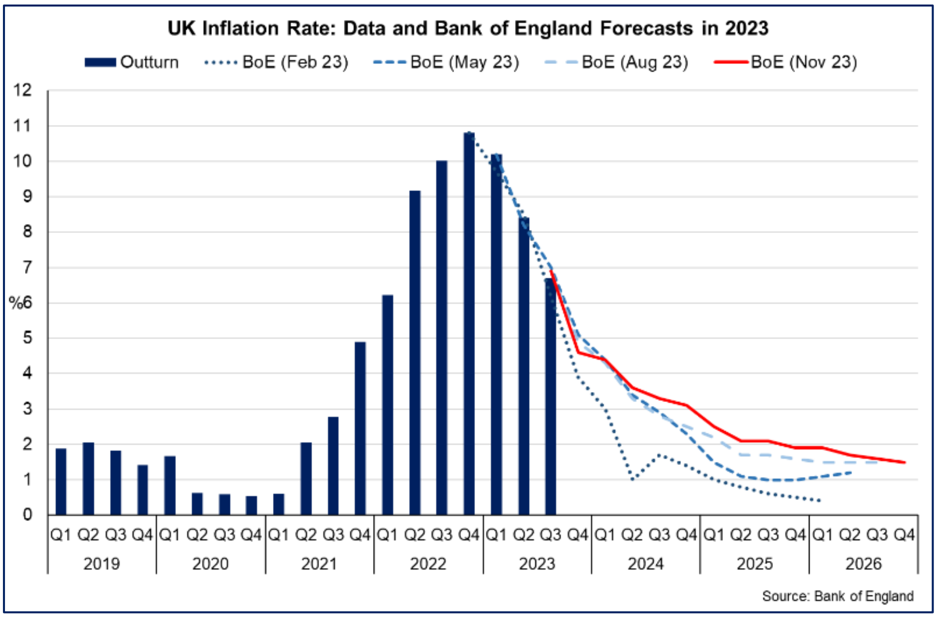
[7] Economic Policy Uncertainty Index
[8] Bank rate maintained at 5.25% - November 2023 | Bank of England

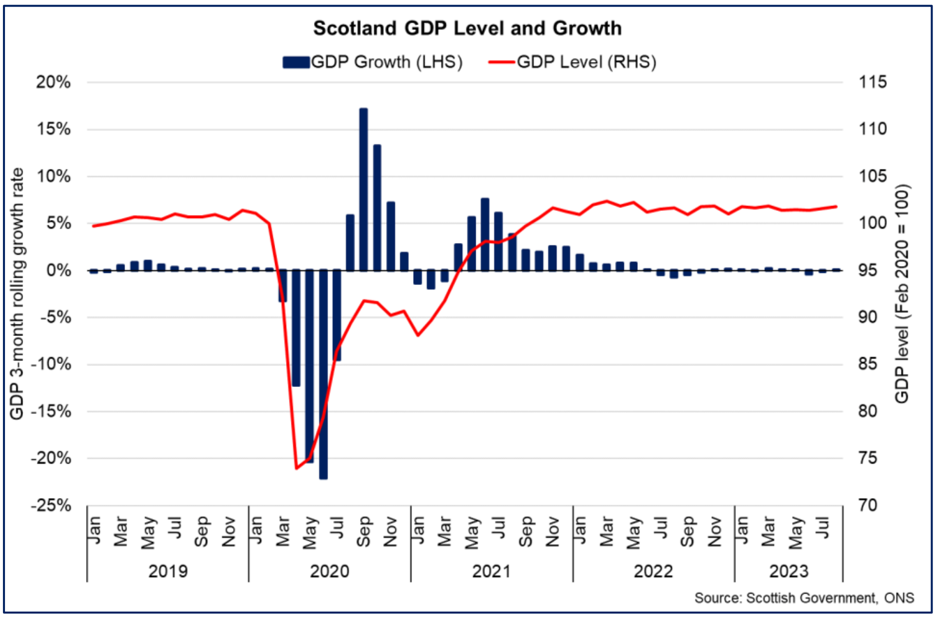


Compared to forecasts from earlier in the year, the fall in inflation is expected to be more gradual, particularly in the services sector, with inflation approaching the 2% target in the second half of 2025.

Weakness in Economic Growth

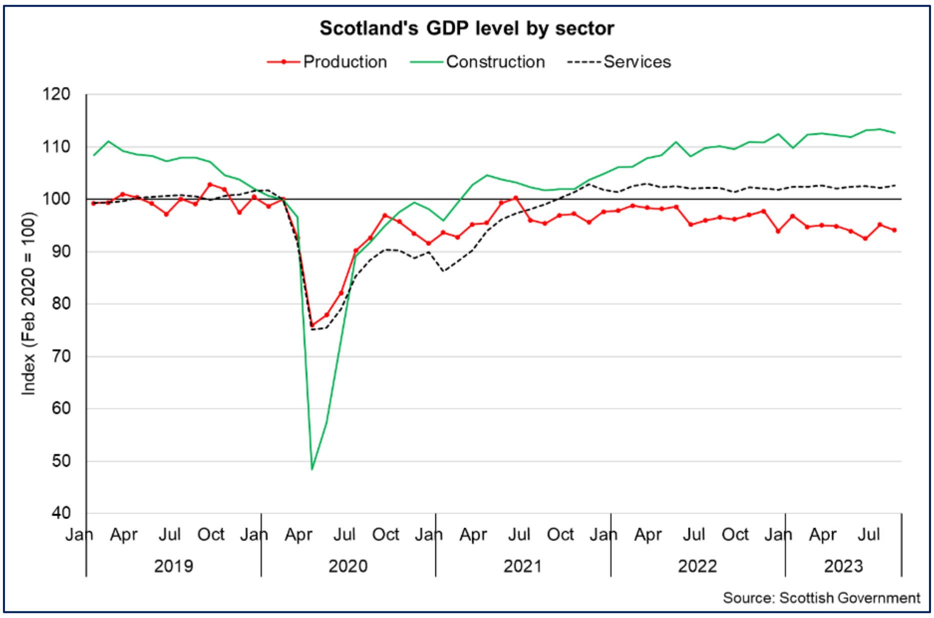
The Scottish economy has proven resilient in 2023 having previously been forecast to fall into recession during the year. This has not happened, however there is an underlying weakness in economic growth with GDP growth remaining broadly flat since the start of 2022 with latest data for August showing growth of 0.1% over the past year.[9]

This reflects a stalling in the recovery from the pandemic as the economic output has remained broadly unchanged at 1.8% above its pre-pandemic level since the start of 2022.



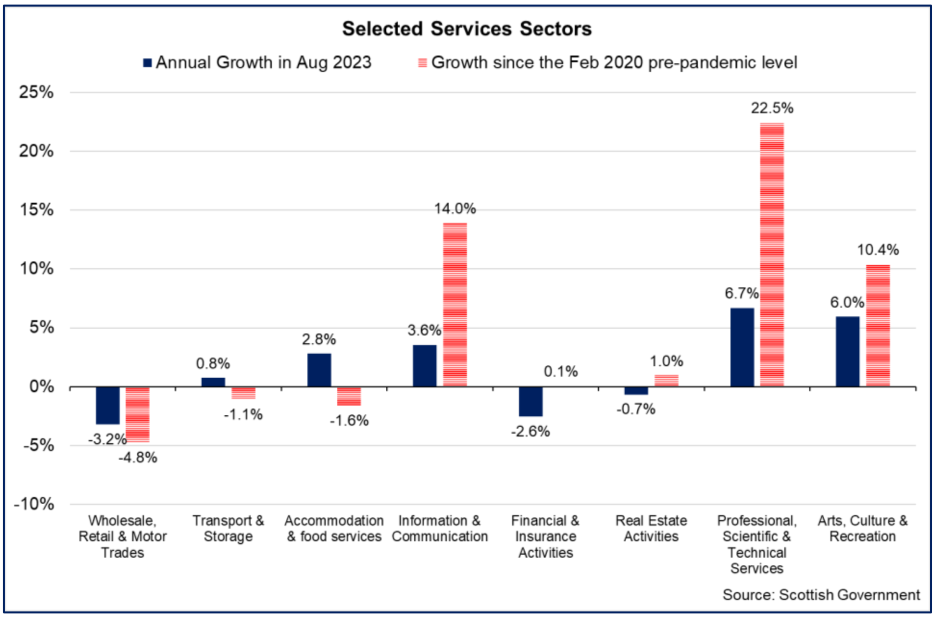
[9] Economy statistics - gov.scot (www.gov.scot)

Output growth has varied across sectors over the past year with growth in the services (0.5%) and construction (2.3%) sectors offset by a fall in production output (-2.5%). This pattern is even more pronounced when comparing back to pre-pandemic levels in which construction is 12.7% above its pre-pandemic level and services is 2.7% above, while the production sector is 5.9% below.



The legacy impacts from the pandemic - from the restrictions that had been in place alongside the disruption in global supply chains - were very much key factors in the differences in sector growth leading into 2022.

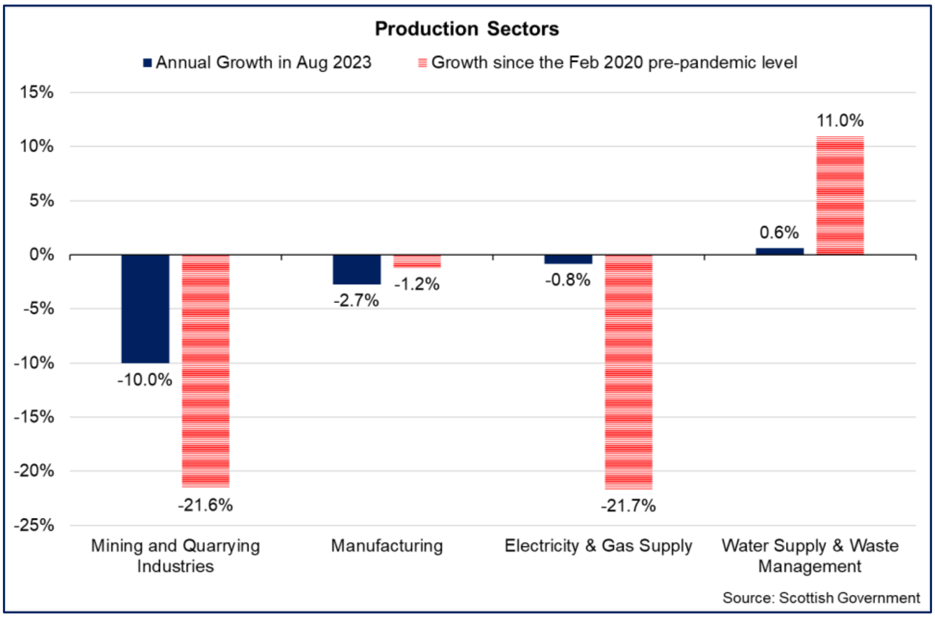
However since then, the inflation shock, tightening monetary policy (their impact on demand) and the cumulative impacts on economic confidence and risks mean that these factors have had an increasingly significant role over the past year.



In the services sector, this is evident when considering how different parts of the sector have grown over the past year and how their output compares to their pre-pandemic level. Despite the inflationary pressures over the past year, growth has been resilient in some of the more consumer facing services sectors such as Accommodation and Food Services and Arts, Culture and Recreation, while Wholesale and Retail output has contracted.

However, output from Accommodation and Food and Wholesale and Retail remain below their pre-pandemic level of output in February 2020, reflecting the combined impact (alongside other factors) that the succession of shocks from the pandemic and inflation have had on these sectors.

Financial and Insurance activities output contracted over the past year and are only marginally above their pre-pandemic level of output. In contrast, services sectors that have grown more strongly over the past year and have recovered to notably above their pre-pandemic levels include Information and Communication and Professional, Scientific and Technical services.



Looking at the production subsectors provides insight on why the sector has contracted over the past year and remains below its pre-pandemic level of output. Apart from the growth in water supply and waste management sector, the other parts of the production sector have seen falling output over the past year and when compared to pre-pandemic levels.

Manufacturing, which makes up 10% of Scotland's total GDP and 66% of the production output has contracted by 2.7% over the past year and is 1.2% below its pre-pandemic output level, while Mining and Quarrying and Electricity and Gas Supply are more significantly below their pre-pandemic levels (-21.6% and -21.7% respectively). Mining and Quarrying in Scotland is dominated by oil and gas support services, including exploration and drilling, which has seen low levels of activity since 2020. Electricity and Gas is volatile, with recent low output due to a combination of good weather conditions (low renewable generation) and maintenance at other power stations.

Scotland's Gross National Income

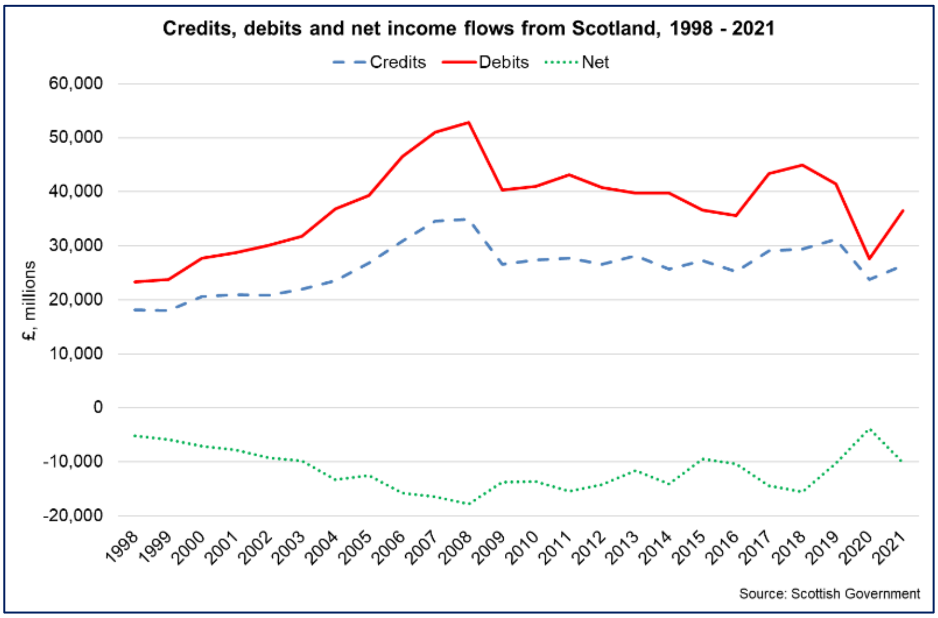
In June 2023, the Scottish Government published provisional estimates up to 2021 of Scotland's Gross National Income (GNI).[1]

GNI complements GDP as a measure of economic activity. While GDP is a measure of how much income is generated in a country through the production of goods and services, regardless of whether it accrues to residents, GNI is a measure of how much income the residents of a country receive.

As such, the value of GNI is equal to GDP plus the net income from overseas sources such as cross border employee earnings and property income such as interest, dividends and other returns on investment. For Scotland, the estimated value of GNI accounts for net income from both the rest of the UK (RUK) and the rest of the world (ROW).

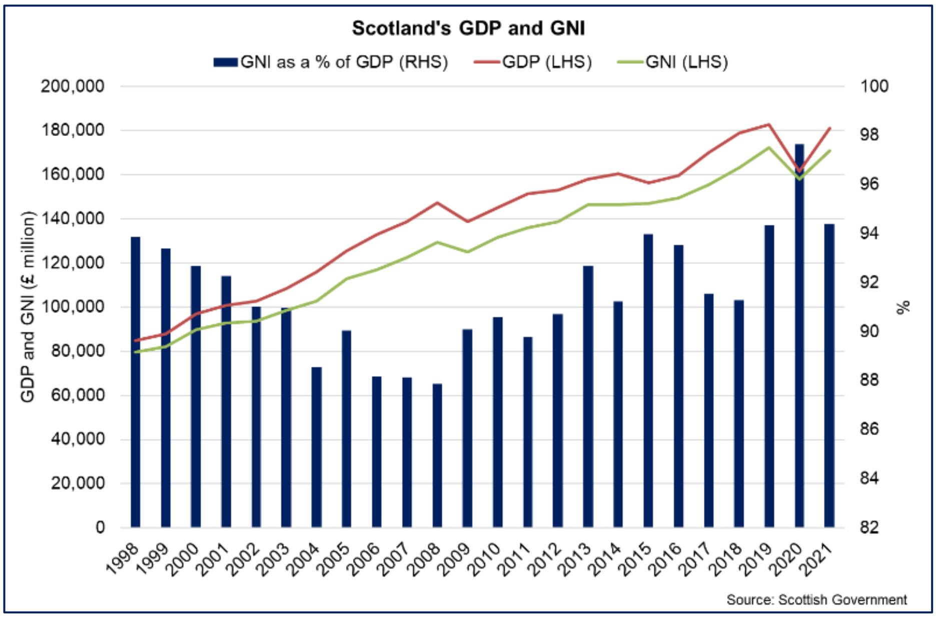
The Primary Income Account provides the estimates of the flows of primary income into and out of Scotland, based on the ownership of economic assets. Income flows into Scotland's Primary Account from earned income and returns on investment from Scottish owned overseas assets, while overseas owned assets in Scotland generate outflows from the Primary Account.

In 2021, Scotland's Primary Income Account showed a net outflow of £10.1 billion, or 5.6% of GDP. As such Scotland's GNI, including a geographical share of UK extra-regional activity, is estimated at £170.8 billion, or 94.4% of Scotland's GDP of £181.0 billion.



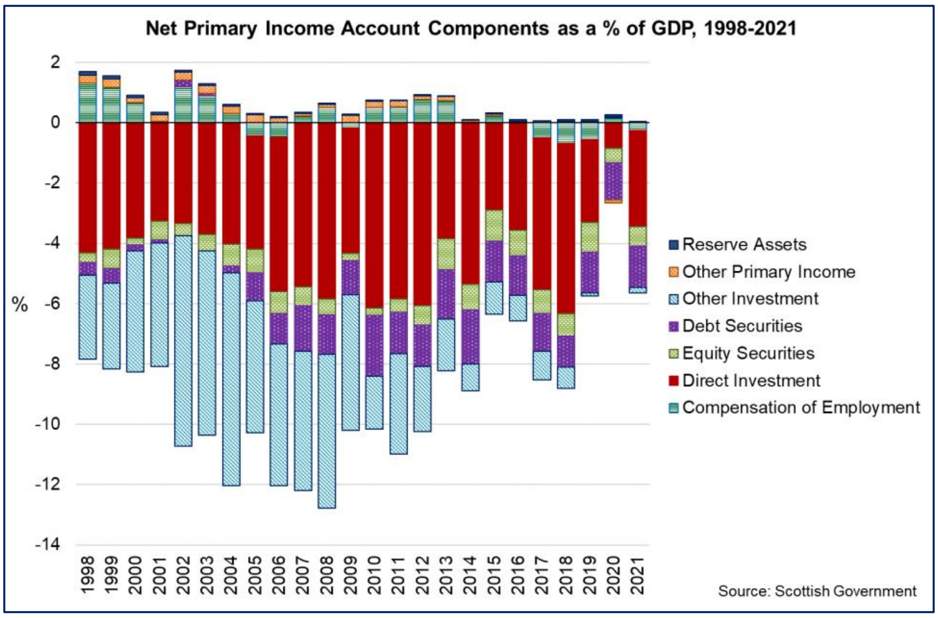
Looking over the longer term, every year between 1998 and 2021, Scotland's primary income debits (flows of income from Scotland to investors in RUK and ROW) have been higher than credits (flows of income into Scotland), creating a primary income deficit (or a negative net balance).

As such, Scotland's GNI has remained below GDP throughout the period from 1998 to 2021, reflecting the primary income deficit over this period. The gap is estimated to have narrowed since its largest estimated value in 2008 in which the primary income deficit was -£17.8 billion. On average, between 1998 – 2007, GNI was 90.6% of GDP, increasing to 92.5% between 2008 – 2021.



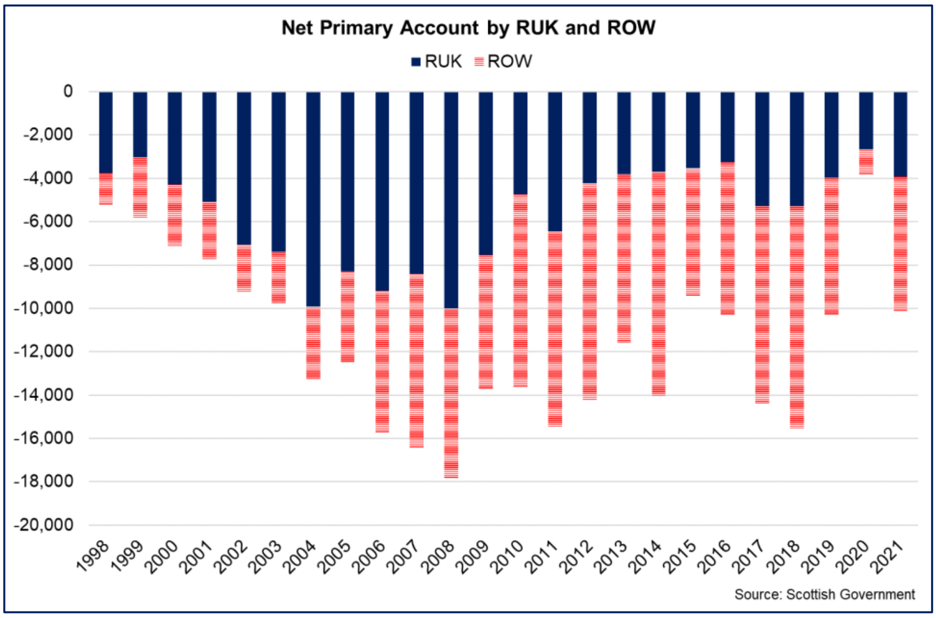
The primary income account deficit is driven by a range of factors including relatively high levels of foreign ownership among Scottish industries and a relatively low proportion of UK companies having headquarters in Scotland, particularly in the oil and gas and financial services sectors.

In 2021, the majority of the income flows made a negative contribution to the Primary Income Account and GNI. The largest outflow was returns on direct investment (-3.2% of GDP) followed by portfolio investment from debt securities (-1.4%) and equity securities (-0.7%).



Since 1998 the gap between GDP and GNI has been largely driven by direct investment. Net contributions of other investment flows had also made a large negative contribution to net Primary Income, however this has reduced in more recent years.

For Scotland, the estimated value of GNI accounts for net income from both the rest of the UK (RUK) and the rest of the world (ROW). Since 2008, Scotland has a net primary account deficit (net outflow) with both RUK and the ROW.



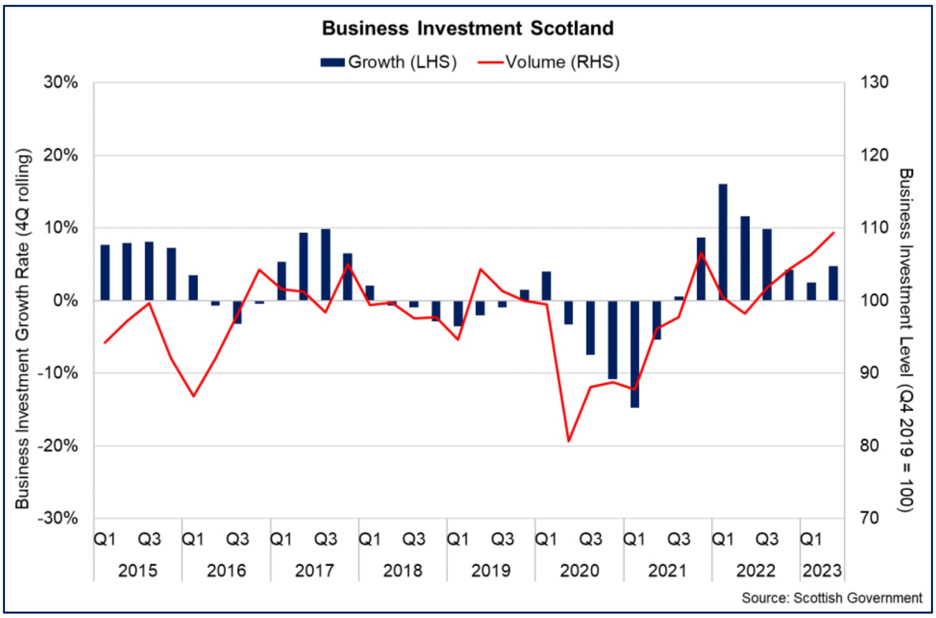
Since 2010, the deficit with the ROW has been notably larger than for the UK, apart from in 2020 during the pandemic when there was a sharp fall in the deficit across the board. This has predominantly been driven by a decrease in the net deficit of other investment with RUK coupled with an increase in the net deficit with the ROW on portfolio investments of equity securities.

Outflows to RUK, returns on investment, were higher in the years leading up to the 2007-2008 financial crisis but have been estimated to be lower since, with the results of the latest years including the impacts of the pandemic.

Overall, the GNI measure provides a valuable insight on the domestic economic wealth of Scotland. Although GNI has remained below GDP throughout 1998 to 2021, the gap has slightly narrowed from 2008 onward. In recent years, volatility in direct investment income flows has been dominant, and reflects both the economic disruptions during the pandemic and corporate financial management strategies of companies operating in Scotland.

Looking ahead, the fall in inflationary pressures should present opportunities for growth, however conditions continue to remain challenging for businesses and households as they continue to adjust to higher prices, higher interest rates and are increasingly concerned about weakening demand.

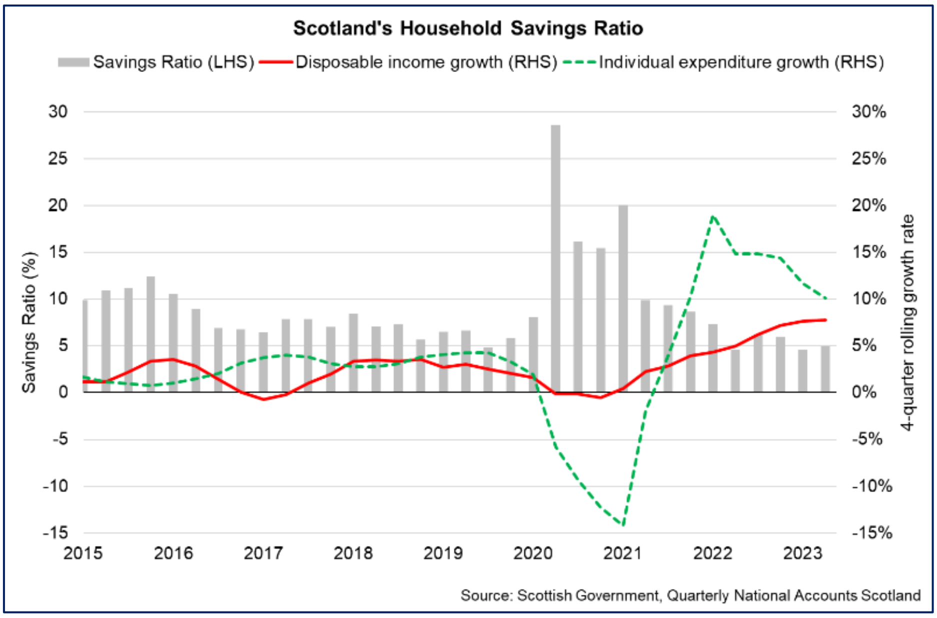
Business investment grew over 2022 as investment recovered from a sharp fall during the pandemic. The pace of growth slowed over the year, however picked up in the second quarter of 2023 growing 4.7% on a rolling four quarter basis. Furthermore, business investment in Q2 2023 had grown 11.3% over the year and is 9.4% above the pre-pandemic level in Q4 2019.



However business surveys indicate that business investment intentions have stagnated during the year. The Scottish Chambers of Commerce Quarterly Economic Indicator reported for Q3 2023, that while on balance, more firms continued to report increases in investment than falls, over half (55%) reported no changes to total investment with this rising to 57% for training investment. Both are five-year highs for the survey.[10]

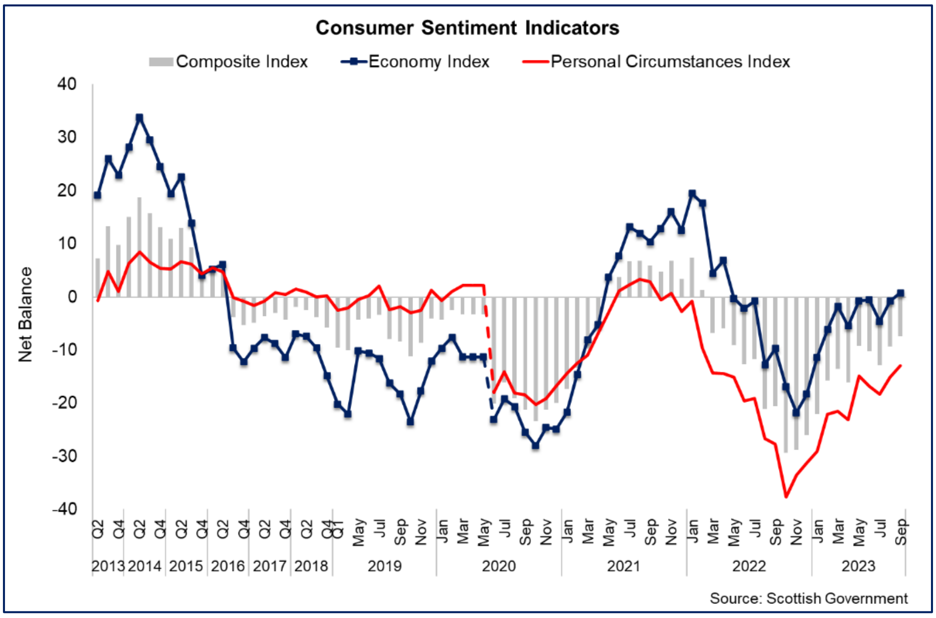
Households also continue to face financial challenges from inflationary pressures feeding through to higher cost of living. Income, expenditure and savings patterns are continuing to adjust from the pandemic when a combination of Covid restrictions and the furlough scheme resulted in a sharp increase in the household savings ratio. The build-up of savings during that period alongside a pick-up in disposable income growth supported a rebound in expenditure growth in 2021-22.

[10] SCC QEI Q3 2023 - Report (scottishchambers.org.uk)



Over the past year, income growth has continued to rise and was 7.8% in Q2 2023 (on a 4-quarter rolling basis) while individual expenditure growth moderated to 10.1%, having peaked at 19% growth in Q2 2022. The savings ratio has moderated as a result (to 4.9% in Q2 2023) and in recent quarters has fallen to its lowest rates since 2006.

The slowing in individual expenditure growth is reflected in the Scottish Consumer Sentiment Indicator which fell during 2022 and while it has been recovering over 2023, remains notably negative on balance. This has coincided with the slowdown in economic growth and rise in inflationary pressures, with households particularly concerned about the impacts on their personal circumstances including their household's financial security and their confidence to spend money.[11]



The weakness in business investment intentions and consumer sentiment present risks to the outlook for growth. There are variations across forecasts, reflecting the uncertainty in the economic

[11] Scottish Consumer Sentiment Indicator : Monthly Data - gov.scot (www.gov.scot)

outlook and the extent to which factors such as higher interest rates and weak consumer and business sentiment will impact on growth.

Collectively however, latest GDP growth forecasts illustrate weak growth in the near term. At a UK level, the Bank of England forecast UK economic growth to slow from 0.5% growth in 2023 to flat growth in 2024 (0.0%), while the average of new independent forecasts reported on by HM Treasury forecast 0.5% growth in 2024.[12],[13]

In Scotland, recent forecasts from the Fraser of Allander Institute forecast Scottish economic growth to pick up in 2024, rising from 0.2% to 0.7%, while the EY Scottish ITEM club forecast a more moderate pick-up in GVA growth from 0.2% in 2023 to 0.3% in 2024.[14],[15]

Labour Market Resilience

Scotland's labour market has performed strongly at the headline level as the economy emerged from the pandemic and in the face of weakening demand over the past year. Following the end of the furlough scheme in October 2021, there was significant uncertainty around how businesses' staffing levels, recruitment activity and availability of labour would adjust to the removal of this government support.

A combination of the rebound in demand and labour and skills shortages resulted in labour market tightening, and unemployment has remained low over this period, while many businesses have faced recruitment challenges, staffing shortages and upward pressure on wages.

The latest headline labour market data for July to September 2023, indicates that unemployment was 3.9% in Q3 2023, down marginally from the second quarter however has picked-up from the record lows observed over the past year. Similarly, the employment rate has fallen over the past year to 74.3% (down from 75.3%) and inactivity has risen from 21.9% to 22.7%.[16]

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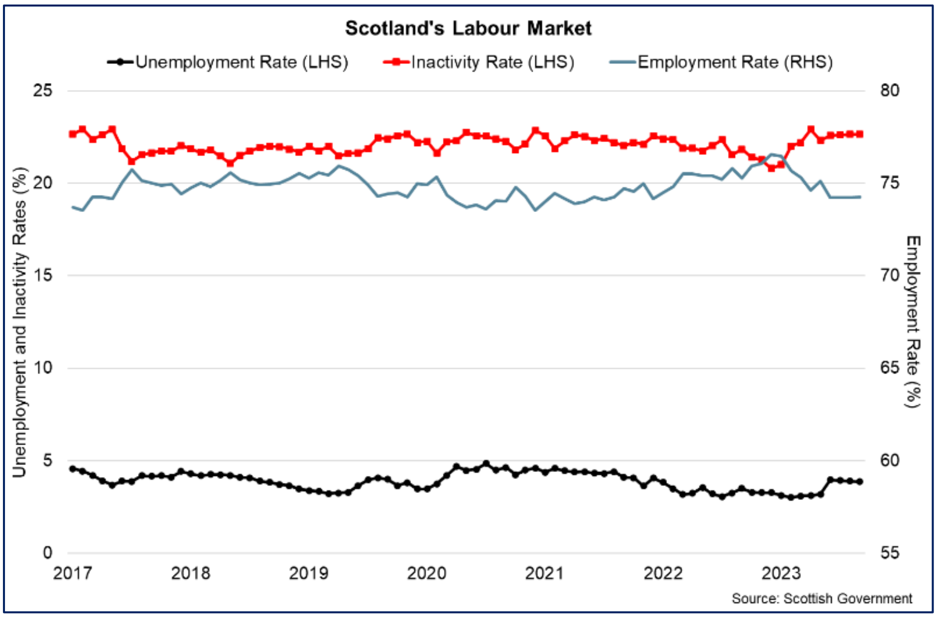
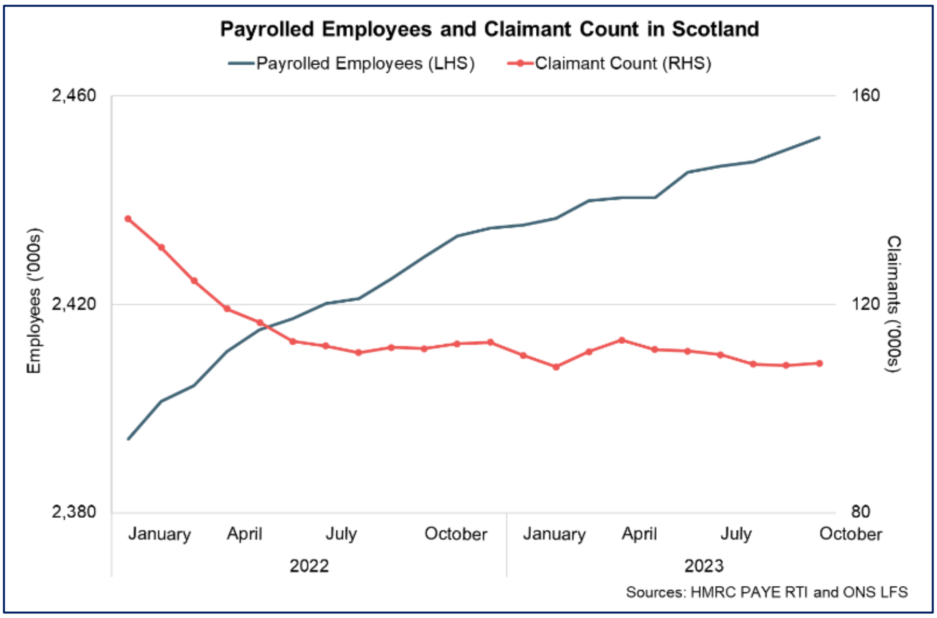
12 Monetary Policy Report - November 2023 | Bank of England
13 Forecasts for the UK economy - GOV.UK (www.gov.uk)
14 FAI Economic Commentary 2023 Q3 | FAI (fraserofallander.org)
15 Scotland's economy is flat but recession to be avoided | EY UK
16 Labour market statistics - gov.scot (www.gov.scot)

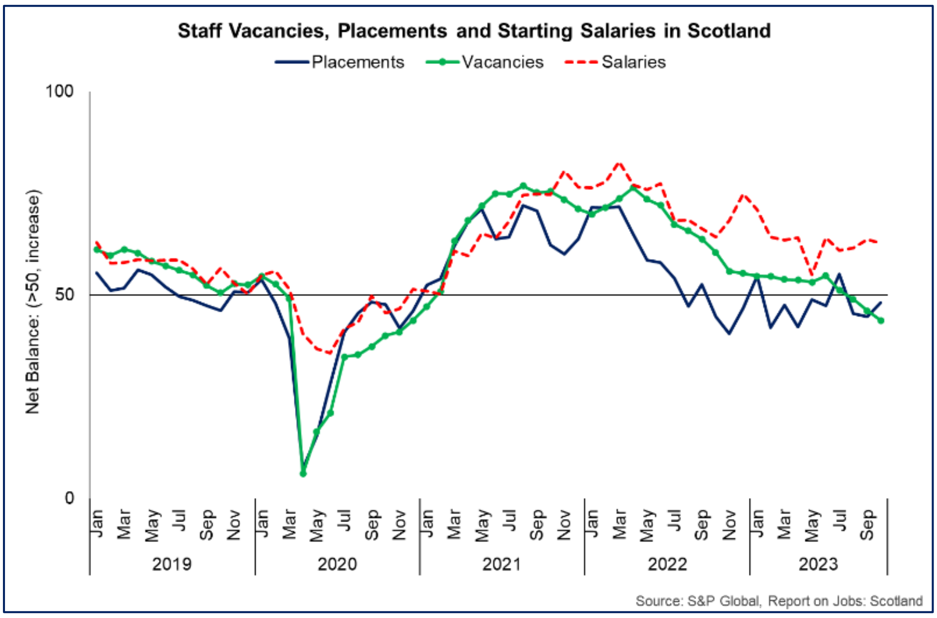


The latest headline data are ONS adjusted experimental estimates due to the increased uncertainty around the ONS Labour Force Survey (LFS) estimates. To monitor labour market conditions effectively and establish emerging risks, this reinforces the importance of using a range of data and survey material as indicators of the labour market.

Pay As You Earn Real Time Information data and Claimant Count data also indicate that the labour market has remained resilient. The number of payrolled employees in Scotland increased 2,000 over the month in October and is up 23,000 (0.9%) over the year, while the claimant count unemployment rate is 3.6% with the number of claimants of unemployment related benefits (108,700), down 2.6% over the past year. Furthermore, PMI data for October reported that businesses in Scotland continued to add to their head count for a ninth consecutive month and at the fastest rate in the UK.



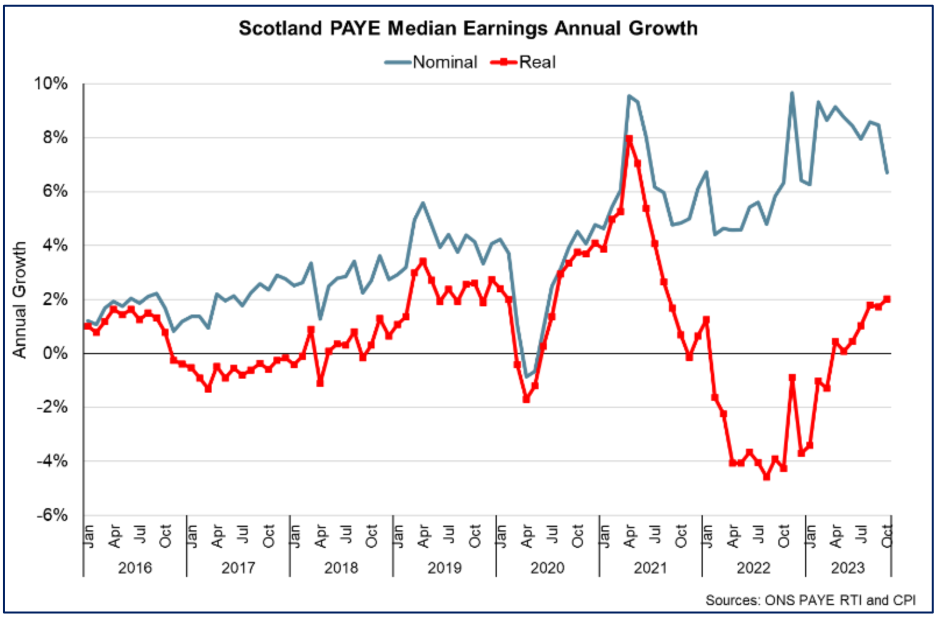
While there is clear resilience in the labour market, business surveys indicate that recruitment pressures are cooling as economic uncertainty is weighing on the supply and demand of labour. The RBS Jobs Report shows recruitment of permanent staff fell for a third consecutive month in October, with a further fall in vacancies and the availability of staff.[17]



However there remains underlying tightness in the labour market. Data from the Business Insights and Conditions Survey indicate that in October, 25.4% of businesses experienced worker shortages; most common in the Construction (38.7%) and the Accommodation & Food (37.9%) sectors, while in September, 37.2% of businesses experienced difficulties recruiting employees, particularly in the Accommodation and Food (40.0%) and Information and Communication (36.6%) sectors.[18]

As such, while starting salaries growth has softened over the past year, it has remained robust. More broadly, nominal earnings growth has also remained elevated, though the pace of growth has moderated in recent months.

[17] S&P Global, RBS Report on Jobs: Royal Bank of Scotland Report on Jobs – October 2023 | NatWest Group
[18] Business and innovation statistics - gov.scot (www.gov.scot)



Over the year to October, median PAYE monthly earnings grew 6.7% in nominal terms having averaged 8.4% annual growth on average in 2023 up to that point. Adjusting for inflation (4.6% in October) median PAYE monthly earnings grew 2% over the year; its seventh consecutive month of annual real earnings growth and its highest rate since August 2021.[19]

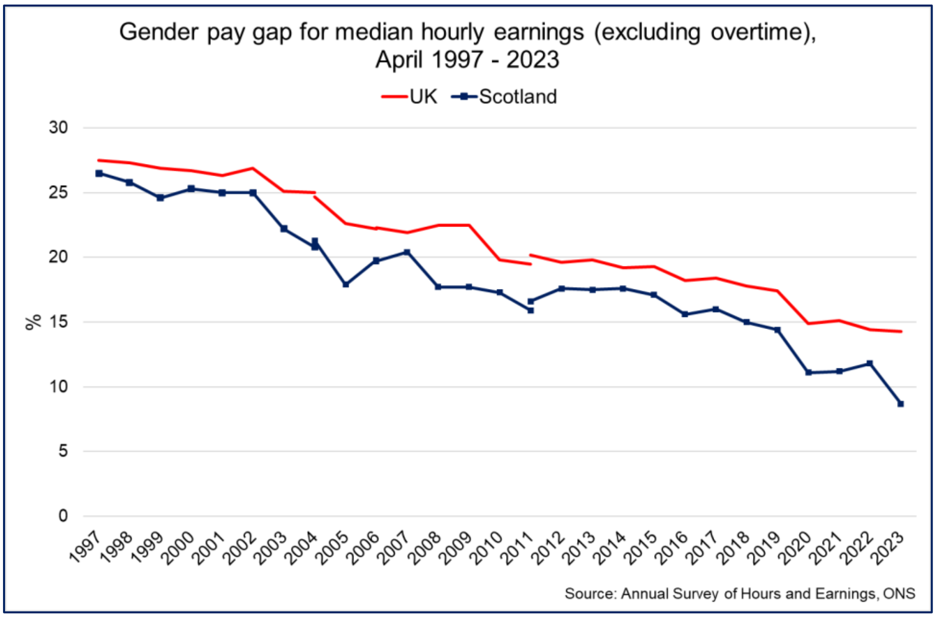
Gender Pay Gap in Scotland and the UK

The Annual Survey of Hours and Earnings (ASHE) is the official source of UK earnings estimates and is used to look at the gender pay gap in Scotland and the UK.[1]

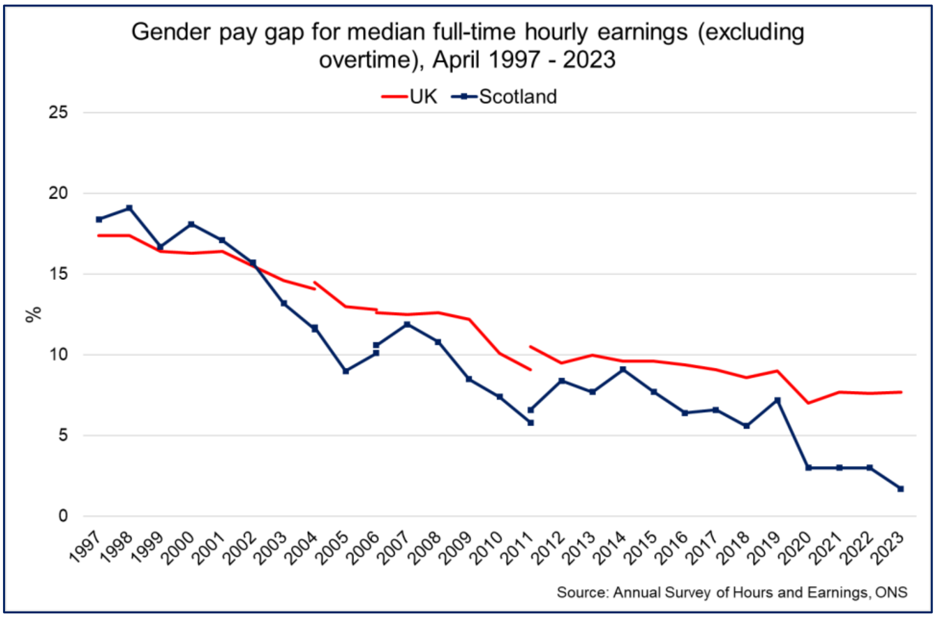
The gender pay gap measures the difference between male and female median earnings (gross hourly earnings excluding overtime) expressed as a percentage of male earnings.

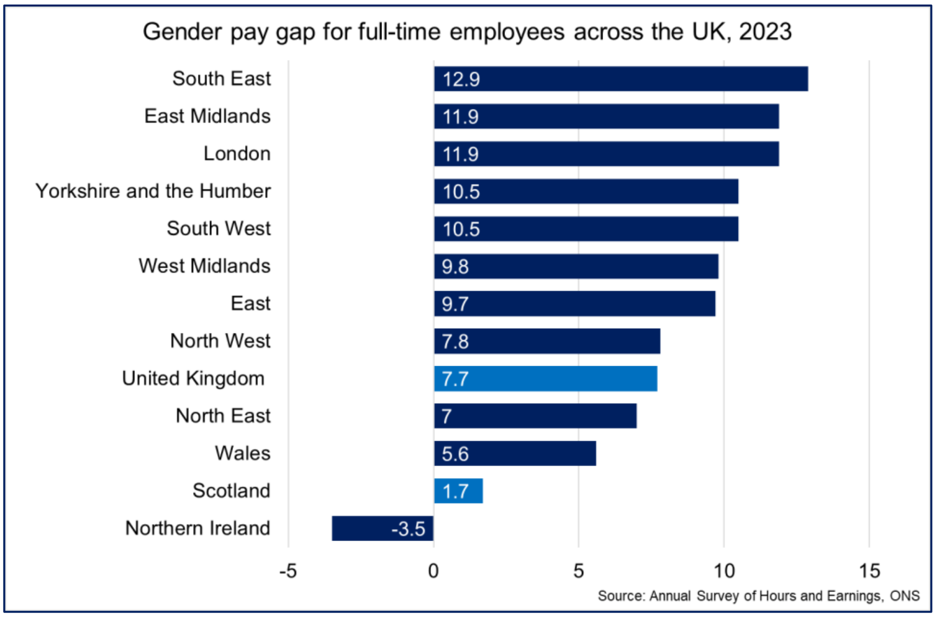
The gender pay gap for all employees has typically been reducing over time for both Scotland and the UK. In Scotland, the gender pay gap was 8.7% in 2023 (down from 11.8% in 2022) and was 14.3% for the UK (down from 14.4%). Furthermore, over the longer term since 1997, both the Scottish and the UK gender pay gaps for all employees has improved significantly (down from 26.5% and 27.5% respectively).

[19] Earnings and employment from Pay as You Earn Real Time Information, seasonally adjusted - Office for National Statistics (ons.gov.uk)



For full-time employees, in Scotland, the gender pay gap was 1.7% in 2023 (down from 3% in 2022) and was 7.7% in the UK (up slightly from 7.6%). This has also improved significantly over the longer term since 1997 when the pay gap was 18.4% in Scotland and 17.4% in the UK.

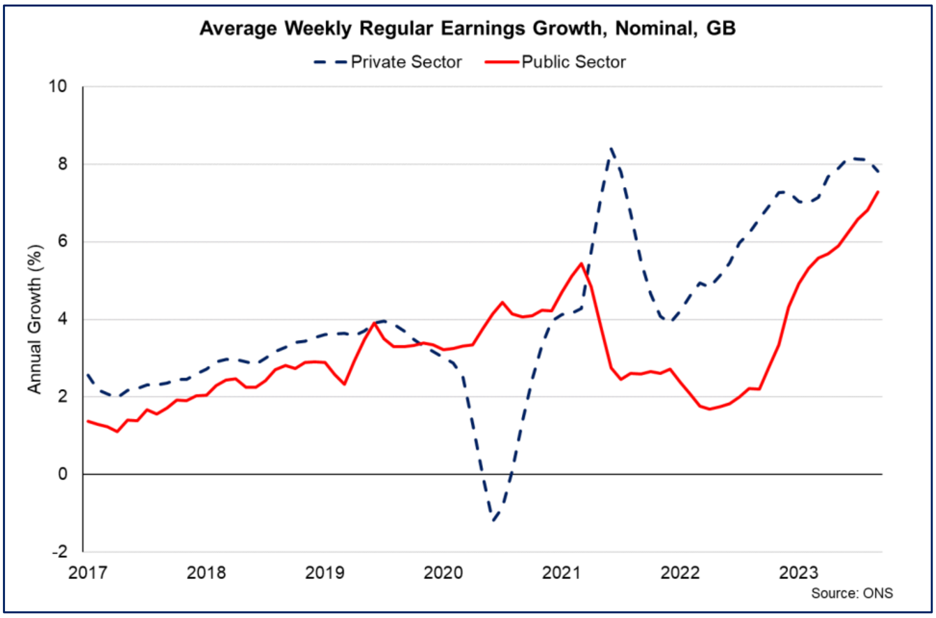




There is a large variation in the gender pay gap across regions, with Scotland having the second lowest gender pay gap for both full-time and all employees.

Average weekly earnings data provides insight into the difference between earnings growth in the public and private sectors at a GB level. Growth in private sector regular pay eased to 7.8% over the year to July-September (down from 8.1% in recent months) while public sector regular pay annual growth picked up to 7.3% (from 6.8%), with the recent gap in recent growth rates continuing to narrow.[20]

[20] Average weekly earnings in Great Britain - Office for National Statistics (ons.gov.uk)



Looking ahead, the Bank of England's Agents' Summary of Business Conditions for Q3 2023 reported that pay settlements for 2023 continued to average 6 - 6.5%, though most respondents expected the level of settlements to reduce over the rest of this year and then reduce further next year.[21]

Conclusion

This edition of *Scottish Economic Insights* has focused on three characteristics of current economic conditions in the second half of 2023 and how they have evolved over the past year and since the pandemic.

Inflationary risks have eased over the past year as the inflation rate has fallen. Inflation has increasingly become driven by domestic factors, with labour costs the main driver in the most recent period. Despite this, we have continued to see resilience in the economy, which has avoided a recession, although performance remains weak. Both falling inflation and the economic resilience are reflected in the labour market, which has seen a return to real earnings growth, following a sharp contraction during the inflationary shock over the past 18 months. Despite the shocks to the economy, progress continues to be made in key areas, with the gender pay gap falling further in 2023.

Overall, while these indicators indicate a slight improvement in cost pressures for households and businesses, they are expected to remain fragile with downside risks. Alongside this, the forecast for growth over the coming year remains subdued with weak consumer sentiment a downside risk to consumption and growth in the near term. However, expectations and confidence can shift and there is potential to see growth supported by continued external demand and investment in Scotland. However, given the nature and scale of recent shocks this will remain a gradual process.

[21] Agents' summary of business conditions - 2023 Q3 | Bank of England

Scottish Government
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Any enquiries regarding this publication should be sent to us at

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St Andrew's House
Edinburgh
EH1 3DG

ISBN: 978-1-83521-730-6 (web only)

Published by The Scottish Government, November 2023

Produced for The Scottish Government by APS Group Scotland, 21 Tennant Street, Edinburgh EH6 5NA
PPDAS1392314 (11/23)